A Statistical and Business Model Examination of the Economic Legitimacy of Multi-Level Marketing

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The MLM Industry

The Direct Selling Association claims that the MLM industry annually generates $30 billion on Main Street USA from 15 million "direct sellers." But this "sales" figure projects *retail* sales by the 15 million "direct sellers." In fact, none of the major MLMs verifies such sales and no physical evidence of significant and profitable retail selling exists. Moreover, most MLMs now say the great majority of their salespeople "self-consume" the products, not resell them. Measuring revenues only in terms of *actual* sales to the millions of MLM distributors shows, without assuming or projecting a retail margin, a USA revenue level of about $20-25 billion.

Companies	All Distributors USA 2012	Total Revenue USA 2012	Total Revenue Global 2012
Amway	743,500	$1.2 Bil	$11.3 Bil
Nu Skin	193,826	$242 Mil	$2.2 Bil
Herbalife	493,862	$816.9 Mil	$4.072 Bil
Total	**1,431,188**	**$2.259 Bil**	**$17.57 Bil**

Using that figure, plus the DSA's claim that there as many as 15 million households under contract to MLM companies, the three MLMs examined in the Coalition's report, Amway, Nu Skin and Herbalife, account for more than 10% of the entire USA industry. Aggregate USA revenue of the three was $2.259 billion (in sales to the distributors) and total distributors of the three were 1.43 million at the end of 2012. This is an adequate slice of the total MLM business and taken from among the oldest, largest and best known companies to be representative of the "industry." What does it show us?

Black Box

The data for this study were compiled from official "income disclosures" of the three companies, SEC filings of two of them and publicized statements from top company officials. They aggregate business fundamentals such as total USA revenue, total numbers of "salespeople" at year-end 2012, mean average incomes gained by each of the various "levels" of the MLM sales channel, potential per capita *retail* profit for the salespeople, and mean average *purchase* levels of the salespeople. The data also show how funds called "commissions" paid to USA distributors, are allocated.

The median average income for distributors of all three companies combined including the median for the incomes of the top 37% that are considered "active" or "leaders," is zero.

There are several factors in this data analysis that skew or otherwise alter the picture which is already murky due to the shallowness and scarcity of the data that is available. For example, all the disclosed "averages" are *mean* averages (total dollars divided by total participants). *Median* (half more and half less) would obviously provide a truer picture to a potential new recruit. The *median* average income for distributors for all three companies combined, including for median of the incomes of the top 37% that are considered “active” or leaders is *zero*. More than half earn nothing.

More than half of all distributors and more than half even of the upper group of “active” distributors earn nothing in commissions.

Additionally some companies employed the statistical manipulation of taking average payouts per month and then multiplying these averages by 12 to produce what they call “annualized” average incomes. This is a false representation. It in no way indicates what is paid annually on average to distributors. They is composed of monthly payments to different individuals each month, not the “average” income gainer, the majority of whom earned zero.

Nu Skin, represents the most egregious use of data misrepresentation. Ninety-five percent (95%) of all Nu Skin distributors earn *nothing* in payments from Nu Skin. Eighty-seven percent (87%) of those defined as “active” also *earned zero* in commissions. When Nu Skin publishes the statement in its “disclosure”, *“In 2012, the average monthly commission paid to U.S. Active Distributors who earned a commission check was $1,010.26, or $12,123.12 on an annualized basis*”, the reader must first know that Nu Skin factored out 95% of all participants. The reader must also know that the “annualized” figure does not represent annual “income”. It merely multiplied the monthly payments by 12. It does not mean that the “average” receiver of a check actually made this much in a year or any significant number of them did. In fact, of those who received checks, the ones in levels with average incomes below this published figure of $12K actually earned only $2,472 and they constituted 91% of the total of those getting checks. These are extraordinary and deviously designed misrepresentations, rendering the “disclosure” useless of due diligence without careful use of some algebra.

Other factors that serve to mislead potential recruits and skew the results of an analysis include that costs are not disclosed, so all “incomes” are merely dollars received. Those “income” figures are not to be confused with actual profit. Related to this factor is that costs factors, which are an obvious element of all “business opportunities,” are not even estimated, so no calculation can be made as to actual profit, if any, even for those at the top ranks.

One of these skewing factors bears special notice. The payments to all USA-based distributors include rewards based on purchases made by sub-distributors outside the USA. Since the great majority of all income for these three companies comes from outside the US (80 - 90% in all cases), the incomes of the very top level distributors are significantly inflated in relation to US revenue. This, in turn, inflates the “mean” average of the upper sector.[1]

[1] Amway data, for example, show total commission payments of 69% of USA revenue but Amway pays only about 40% of total revenue in commissions. Herbalife data shows 45% of USA revenue paid out but SEC filings show only about 33% of net revenue paid in commissions.

None of the companies discloses the geographic origins of the rewards. The withholding of this geographic source can be terribly misleading to a new recruit. Without knowing that much, perhaps nearly all, of the highly promoted incomes of the top "leaders" may be coming from as far away as China, the USA recruits may believe they could also achieve those income levels by recruiting locally.

Companies	Top 1% (approx.) of Actives and Leaders • Total Number • % of Entire Chain • Average Income	• Total Payout to the Top 1% of Actives • % of Total Commissions Paid to Top 1% of Actives
Amway	• 3,345 (.97%) • 0.42% of entire sales chain • $108,675 av. income p. yr.	• $363,520,214 • 44%
Nu Skin	• 997 (1.29%) • 0.5% of entire sales chain • $103,030 av. income p. yr.	• $102,625,644 • 81.7%
Herbalife	• 1,185 (1.04%) • 0.24% of entire sales chain • $206,638 av. income p. yr.	• $244,866,604 • 66%
Total	• 5,527 • 0.39% of entire sales chain • $128,643 av. income p. yr.	• $711,012,462 • 54% of all payouts

The Peak of the Pyramid

The most glaring data point from the analysis is that only about 5,500 out of 1.4 million people are in the levels of the chain in which the disclosed average income approximates what might be called a "livelihood", $60,000 or more a year in gross income *before* all purchases and business expenses are subtracted. This peak of the pyramid (0.39% or one in two hundred fifty) gained a *mean* average of about $129,000 a year in gross income, before expenses. (the *mean* average is skewed upward by the extremely high incomes of the tiny few at the very peak, whose incomes are globally based.) They received 54% of total commission dollars paid out by the three companies. In total this tiny group at the top of sale chain received the equivalent of 32% of the three companies' entire USA revenues. The payments are based only upon the *purchases* – not sales – of the other 99.6%.

The paucity of "success" in the industry raises obvious business model questions. What did this top 0.4% do to receive over half of all sales commissions? Management genius? Super-sales volumes personally? Hands-on training? None of these traditional "values" on which commission percentages are normally based apply. The top players are light years removed from the actual selling and recruiting events below, though they stimulate it with promotions, conferences and rallies and ultimately every person in the entire chain is in their "downline", a theoretically infinite genealogical chain of recruits. At the absolute top, the chain immediately divides under the top recruiters into their various "lines" of sub-distributors that, theoretically would compete with one another for sales and new recruits, as all independent distributors do in any geographically unprotected open market. But, lines of distributors within these MLMs are contractually prohibited from soliciting or even communicating with one another's members. Competition between the lines of sales is prohibited by Amway.

The top 0.4% receive an amount equivalent to 32 cents of every dollar spent by the bottom 99.6% of the USA distributors.

The sub-distributors in the lower ranks cycle in and out annually at extraordinary rates, precluding any significant management or "training" role for the top members. Indeed, with little verified retail selling, the only function to manage or train for is the national recruiting system. Since these 0.4% distributors are not equity owners, their commission apportionments are based purely on respective position on the sales chain, and those positions are sustained by a never-ending recruiting program. If the recruiting ends, the income does too. The obvious conclusion is that the top 0.4% gained the lion's share of the rewards because it fulfilled the most valued and critical function of the model, recruiting salespeople.

A Model that Has No Name

But even before such an assessment of what the top tier does for its money, a far larger issue for evaluation arises, indeed the most fundamental of all factors in commercial analysis. If this be a sales channel, w*ho are the sellers and who are the buyers?*

Officially, MLM companies report to the SEC that they sell "through" independent distributors. So, the companies sell to authorized "distributors" who do what all distributors, *by definition*, do – resell to end-users. It is also normal that managers would earn money from the sales of the sub-distributors they recruit and manage, proportionate to their value in the sales cycle, including finding and persuading the prospect, bearing the sales costs and other logistical expenses.

If this be a sales channel, who are the sellers and who are the buyers?

Applying these traditional roles and standards, however, proves useless in examining MLM. In recent years, the largest MLMs have redefined the MLM business model to something that has no name and no precedent. Abandoning Amway's 1979 argument to the FTC Judge that its revenues, and its rewards to uplines, were ultimately sourced from retail purchases by non-distributors, MLMs, including Amway, now say distributors are their customers.[2] In the new definition, MLM companies sell products "directly" to some

[2] In the final ruling in 1979 on the FTC's charge that Amway was an illegal pyramid scheme, the FTC Administrative Law Judge concluded, based on Amway's executives' sworn testimony, that Amway was not a pyramid. He wrote, "The Amway system is based on retail sales to consumers... Amway is not in business to sell distributorships and is not a pyramid distribution scheme."
Yet, in a Feb. 29, 2012 video interview of Amway executives, Doug Devos and Steve Van Andel by *Wall Street Journal* reporter, Dennis Berman, the new MLM narrative in which the *distributors* are the retail customers was made plain.

WSJ Dennis Berman: What percentage of the end products are sold to the general public and not to the Amway salespeople directly?

Amway Doug Devos: That's always a challenge to kind of find exactly what that number is. But its a large percentage. Probably… our research probably about at least half or more would go to an end-user and ultimately all of its goes to an end-user. Even if somebody happens to be a distributor, they are their own distributors, whom they describe as upper segment of a group that itself is in the upper echelon, called "active" or "leaders". These upper level distributors then "sell to" (not manage) other distributors who should be viewed not as contract distributors at all but as ordinary "end-users", i.e., the end of the sales chain, not the channel to the open retail marketplace.

Inside the sales channel, prices are fixed; trade is restrained; competition forbidden.

The problem with this un-named business model is that these companies have no "direct" sales forces that could do such "direct" selling to the thousands of top-level distributors. They have no "national" or "in-house" accounts of their own. *All* sales are accompanied by large commission payments to some members of the *contract* sales force. This is obviously "third party" sales, but who is the third party?

- *All* the MLM salespeople, those now defined as "sellers" and those re-defined as "end-users", are under the same legal contract and are offered the same income proposition.
- *All* are offered "incentives" in cash or "points" (that lead to cash) to buy goods *personally* and to accumulate rewards through increased purchasing and increased recruiting of others to also buy personally and recruit others.
- All buy under the same *contract* terms that impose vertical trade restraints on *all* the contractors, including those the MLM now claims are actually "end-users." All are legally classified as *resellers and* are subjected to the same *channel management* restraints, including those re-defined as "end-users."
- The contracts restrict whom the contractors buy from, if they are re-defined as "customers", and whom they can sell to if they are deemed "salespeople."
- As contractors, even if they are re-defined as "customers", if they ask for a refund, they must resign their contractor status, lose discounts for as much as six months, and forfeit forever whatever sales organization they may have built up.
- All distributors, including those that the MLMs now re-define as "end users" are charged sales tax based on a higher *retail* price, on the presumption that they will *re-sell* the goods for a profit, not keep them as end-users would. States are receiving millions in sales tax from MLMs on retail transactions that apparently never occur and were never even intended.
- The contracts strictly prohibit *discounting* by the distributors that are deemed "salespeople" when they sell to the distributors that are re-defined as "customers." Prices are fixed. Trade is restrained. Competition is forbidden.
- Neither the "customers" nor the "salespeople" are allowed to sell other MLM products to anyone in the MLM while they are under contract. They cannot sell to their *former* downline, even after they leave the MLM.

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best customer. So I would say on a strictly speaking standpoint, a hundred percent, because everyone, at the end of the day, is a customer and they see value in the product or else they wouldn't buy it.

Berman: Right

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- The terms of the *contract purchases* prevent criticism of the company or its products.

Under no known commercial precedent, business law or practice of marketing could such transactions be considered competitive, open-market retail selling. They are non-competitive and they include no retail profit. They all occur inside a sales chain, under *reseller* contract terms.

Buying More than Selling

What about those immediately *below* that 5,500 that gain the average income of $120+K a year? These are distributors who are also "active" or are "leaders." If they are not making the big bucks, are they at least gaining on average the much heralded "part-time" incomes "from home"?

Companies	Average Income of 99% "Active" or "Leader" Distributors Below the Top 1% • Annual • Weekly	Number of "Active" or "Leader" Distributors Below the Top 1%	Total Payout to All "Active" or "Leader" Distributors Below the Top 1%
Amway	• $1,375 per year • $26.44 p. wk.	338,655	$465,487,786
Nu Skin	• $300 per year • $5.77 p. wk.	76,359	$22,911,626
Herbalife	• $1,116 per year • $21.46 p. wk.	111,900	$124,936,556
Total	• $1,164 per year • $22.38 p. wk.	526,914	$613,335,968

The data show that the average income gained by the bottom 99% of the "leaders" and "actives", the upper 525,000 in number out of the overall total of 1.4 million, is only about $1,160 a year. This is less than the average annual purchases of all the distributors, which is about $1600 a year. In other words, after purchasing goods themselves, the bottom 99% of the "leaders" and actives" – and remember, the leaders and actives are the top 37% of the entire chain – are in the hole by about $500, on average, just from buying the goods. What their true losses are is unknown since the companies offer nothing in the way of average or expected business costs in the "disclosures" made to new recruits.

Known for Decades

The figure is startling, but it is far from new. More than 30 years ago, the state of Wisconsin revealed the same pattern when it brought a lawsuit against Amway for making deceptive income claims. Wisconsin's Amway recruits, the state charged, were routinely told they could earn $12,000 a year within just 3 to 9 months of signing up. From discovery Wisconsin found that only the top 1% of the total sales chain, the so called "Directs" who were about 200 out of 20,000, gained an average of $1,200 a month. Within this group, only about 42 individuals, 0.2% of the entire channel, gained the equivalent of today's livelihood figure ($20,000 or more, the equivalent of $60,000 or more today, factoring inflation). The incredible story of Amway's deceptive recruiting campaign in Wisconsin was reported on the popular investigative news show, *CBS 60 Minutes* in which correspondent Mike Wallace interviewed Wisconsin's Assistant Attorney General, Bruce Craig, who filed the suit.[3]

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[3] From the transcript of the *60 Minutes* show:

CRAIG: We're charging them with deceptive business practices because of the use of those hypotheticals because they so vary from what we feel is REALITY.

So, the (less than) 1% pattern was revealed in 1979 along with the less-than-one-half-of-one-percent pattern for the top gainers. Wisconsin's even data went a step further. It showed that even these paltry numbers are illusory because business costs are not revealed. Among Wisconsin's top Amway distributors, on average, the costs wiped out the income and then some. On average, this top 1% group reported an *average net loss* on their tax forms of $918. Net profit, therefore, accrued only to an absurdly small group, in cruel contradiction to Amway's promotional claims. This occurred only months after the FTC had given Amway a get-of-jail pass, which has been valid for 35 years, with no one from the government ever looking again to see if any Amway recruits, more than a fraction of one-percent, earn a profit.

Testing for Retail

Before concluding that the business model of the three MLMs examined in this study operate as closed-markets, employing fixed prices, retraining trade, preventing competition and employing an endless chain promise, the data on *possible* external revenue from retail sales should be reviewed, even if the MLM companies themselves do not document such sales.

Companies	ALL Distributors in USA	Total Revenue in USA	Average Annual Purchases per Distributor	Maximum Possible Gross Retail Profit p. Distrib. at 30% Retail Profit (before all selling costs, discounts, samples, and self consumption)
Amway	743,500	$1.2 Bil	$1,614	$13.30 p. wk.
Nu Skin	193,826	$242 Mil	$1,249	$10.29 p. wk.
Herbalife	493,862	$816.9 Mil	$1,654	$13.63 p. wk.
Total	1,431,188	$2.259 Bil	$1,578	$13 p. wk.

Just as the MLMs do not reveal who exactly the "customers" are *inside* the chain or how much they buy, they also do not identify or quantify non-contract end-users, that is,

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WALLACE: [voice over] Bruce Craig investigated some examples used in Amway literature. Examples that said that Amway distributors could make in excess of $1200 a month. Money that some Amway distributors could be earned with just a few hours a week. But after looking at the average income of the 20,000 Amway distributors in Wisconsin, Craig came to the conclusion that such a claim was outlandish.

[to Craig] Surely, SOMEbody's making that kind of money.

BRUCE CRAIG: Yes. That's correct.

WALLACE: How many? Percentage wise.

BRUCE CRAIG: About one percent.

WALLACE: [voice over] Amway DID make the disclaimer that $1200 a month was ONLY hypothetical but that still doesn't convince Bruce Craig.

BRUCE CRAIG: If the figure of successful distributors was 1 out of 5 as opposed to 1 out of 100 we wouldn't be in court right now.

WALLACE: [voice over] And, Craig says that even the distributors who, on paper, earn an average of $14,000 dollars a year in Wisconsin actually earn a lot LESS. How much do they actually make?

BRUCE CRAIG: After business expenses, a net income of minus $918.

WALLACE: WAAAAIT a MINute! The direct distributors who make a gross income on average of over $14,000 wind up losing almost $1000 after business expenses?

BRUCE CRAIG: On average. Yes.

what would be conventionally understood as retail customers. Could the distributors be successfully retailing, notwithstanding the MLM claims that more than two-thirds of the distributors have no interest in making a profit?

There is no data available on numbers of retail customers, average retail profit margins or average retail sales volume of the distributors. However, the data do provide the aggregate amount that all the distributors *purchase*. This figure represents the total amount that *could be* retailed. The data also offer the total number of distributors. A calculation can therefore be made as to what the maximum possible retail profit the distributors could gain, *on average*. That number is $13 a week. This is the maximum, per capita that could be gained if no products were ever self-consumed, given away, or discounted when retailed. It is based on a generous potential retail profit of 30%.[4]

In sum, the data show there is no potential for a viable retail profit margin. The retail sales opportunity does not exist.

[4] Maximum Possible Gross Retail Profit, on average, is determined by first factoring the average per capita purchases of $1,578 (total revenue divided by total number of distributors). 30% retail profit on these average purchases equates to a 43% mark-up. Average annual purchases of $1,578 sold at a 30% retail profit would factor to total retail sales of $2,254 or a gross retail profit of $676 per yr., or $13 per week, per distributor.